

BIG FLIPPING SCHEMES IN SMALL CITIES? THE CASE OF MANSFIELD, OHIO

Katrin B. Anacker

Abstract

This article presents a Poisson regression model that explains factors that affect neighborhoods with high proportions of potentially flipped properties based on a case study in Mansfield, Ohio. These neighborhoods were characterized by factors similar to those typical of challenged neighborhoods. Potential public policies were suggested that can address property flipping, focusing on the home buyer, the lender, the appraiser, and the inspector. Potential future public policies that address property flipping should especially focus on home buyers in neighborhoods that are characterized by variables that are significant in the model, such as a high proportion of vacant housing units, low housing unit values, and high proportions of senior or African American householders.

Introduction

Several years ago the Baltimore Sun reported on local real estate property flipping in a series of newspaper articles (“An Epidemic,” 2002; “Day of Reckoning,” 2001; O’Donnell, 2000, 2001a, 2001b, 2001c, 2001d, 2001e, 2001f, 2001g; James, 2002). Over a three-year period flippers had purchased dilapidated houses and had flipped them, first selling them back and forth among themselves and, finally, to unsuspecting buyers. In some cases the flipping was done within hours. Based on this newspaper series, the Permanent Subcommittee on Investigations of the Committee on Governmental Affairs of the U. S. Senate reviewed this issue for almost a year and came to suspect that flipping was occurring not only in Baltimore but also around the U. S., based on the witnesses flown in from around the country (U.S. Senate, 2001).

A common flipping scheme works as follows. An investor purchases a property for a low price, typically in a challenged neighborhood (“Better

Katrin Anacker is a Research Assistant Professor at George Mason University, Arlington, VA.

Protect,” 2001). At first, the property is sold back and forth (i.e., it is flipped) between colluding investors or among companies in order to increase the property’s price quickly. The property is then appraised by an appraiser who may or may not be part of the flipping scheme. Even if the appraiser is not part of the scheme, there might be interest in pleasing the entity that contracted for the appraisal. Thus, even under normal circumstances the appraiser feels some pressure to return a high appraisal. The appraisal then justifies a high mortgage from a lending institution, which, again, may or may not be part of the scheme. Finally, the property is sold to an innocent investor or to an aspiring homeowner who may be buying his or her first home. In sum, property flipping

[...] involves the purchase and quick resale of homes at a huge price mark-up, often accompanied by little (or only cosmetic) work to improve the properties, in order to create the false illusion of a robust real estate market through the use of phony paperwork and deceptive sales pitches. (U.S. Senate, 2001, p. 6; see also U.S. Senate, 2000a, p. 57).

In many flipping schemes, a home buyer is stuck with a house for which the price paid exceeds fair value, and which may need costly repairs. Also, the buyer might not have an income sufficient to satisfy the inflated mortgage and property tax payments. In such cases, the buyer’s credit rating is tarnished and his or her chance of buying another home in the future declines (U.S. Senate, 2000a).

Flipping schemes affect not only individual investors or homeowners, but also communities, typically challenged ones (U.S. Senate, 2001). Conceivably, homes on a block that have not yet been flipped could be affected by adjacent properties that have been flipped, because neighboring properties are often compared in real estate evaluation. When a property is appraised too highly, there is justification for inflating the values of adjacent properties. If several investors or homeowners default on their mortgages and their properties become vacant for some time, they may be boarded up. This provides a neighborhood eyesore at best, and an invitation for illegal activities in the neighborhood at worst (Squires, 1992, 2003).

This case study focuses on real estate property flipping in Mansfield, which is located in Richland County, Ohio. Richland County’s Fair Housing/

Community Development Officer believed that properties in low-income neighborhoods had been turning over too quickly and with more rapid price increases than the market warranted (see also Benson, 2002a, 2002b, 2002c, 2002d). He asked for assistance in determining whether flipping was occurring by pinpointing suspect properties. Archived deed transfers based on the county auditor's records served as a basis for the statistical analysis to determine whether flipping had been happening. Unlike other counties in Ohio, Richland County does not make information on properties publicly available. The obtained data set was proprietary.

The Ohio State University's Center for Urban and Regional Analysis (CURA) pinpointed potentially suspect parcels at the census tract level (Community Research Partners and Center for Urban and Regional Analysis, 2002) and made a report accessible on its website. This article builds on CURA's report. The author of this article hypothesizes that neighborhoods affected by potential flipping activities are characterized by housing-unit related and socioeconomic characteristics that are also typically found in challenged neighborhoods, such as a high proportion of vacant housing units, low housing values, and a high proportion of racially and ethnically underrepresented groups, among others.

The current definition of property flipping, with the three components stated above, has two components that make it illegal: the use of phony paperwork and deceptive sales pitches (U.S. Senate, 2000a, 2001). Examples of statutes that address these illegal activities are 18 U.S.C. Section 1341 (criminal mail fraud), 18 U.S.C. Section 1343 (wire fraud), 18 U.S.C. Section 1344 (bank fraud), and 18 U.S.C. Section 371 (conspiracy to defraud the U. S.) (Engel & McCoy, 2002; U.S. Senate 2000a). As of this writing, there is no statute or common law in Ohio that addresses the purchase and quick resale of homes at large price mark-ups. The question remains whether public policies should address such sales when home buyers have low incomes and/or properties are insured by the Federal Housing Administration (FHA).

This article continues with a literature review related to property flipping, including such practices as land-installment contracts. Next, data and the methodology—a Poisson regression—are discussed. This is followed by discussions of the results, public policies, and concluding remarks.

Literature Review

To the author's knowledge there is, as of this writing, no significant academic literature on property flipping. Academic discussions in the context of neighborhood decline have focused on segregation (Carr & Kutty, 2008), racial lending discrimination (Dedman, 1988a, 1988b, 1988c, 1988d, 1988e, 1988f, 1988g), redlining (Guttentag & Wachter, 1980), predatory lending (Immergluck & Wiles, 1999), and subprime lending (Engel & McCoy, 2002). However, contemporary property flipping practices closely resemble land-installment contracts and double sales schemes that were legal and common in the 1960s (Chatterjee, Harvey, & Klugman, 1974; Harvey, 1975; see also George (1955) and Hite (1979)). Both vehicles provided homeownership opportunities for those who were excluded from the conventional housing market, although the terms of these vehicles were disadvantageous in the long run—similar to the homeownership opportunity “provided” by flippers nowadays.

Land-installment contracts were legal and common in the 1960s, as described by Harvey (1975) in the case of Baltimore. Typically, a speculator purchased a house and then added a purchase and sales commission, various financing charges, and overhead costs. Next, the speculator renovated and redecorated the property and added a profit margin. Finally, he sold the house for a much higher price. Before the purchase the speculator took out two loans, one for the amount of the appraised value of the property and another one for the difference between the appraised value and the sale price. These two loans were packaged for the buyer. The speculator retained the title to the property but permitted the buyer immediate possession of the property until the second loan that covered the difference between the appraised value and the sale price was paid off. Then, a new conventional mortgage at the appraised value was taken out, at which time the purchaser retained the title to the property (Harvey, 1975).

For many African Americans, especially those of low and moderate incomes, the land-installment contract was one of the few ways to buy a home. However, due to the setup of the contract, purchasers were forced to buy homes for an inflated price, “paying ‘the black tax’ that was nothing more nor less than class-monopoly rent realized by speculators as they took advantage

of a particular mix of financial and governmental policies compounded by problems of racial discrimination” (Harvey, 1975, p. 155).

When Section 221 (d) (2), FHA’s low income/no down payment program, was introduced in 1968, speculators started to favor double sales activities over land installment contracts because of the insurance aspect. Double sales occur when a property passes through the hands of two or more speculator-investors, increasing in price between transactions and finally being sold through an FHA program (Harvey, 1975). To the author’s knowledge, double sales have not been discussed in the academic literature since the mid-1970s, although flipping has been discussed in governmental reports and the media more recently.

Data and Methods

The Richland County Auditor’s Office made available a comprehensive set of data on property transactions in Richland County between 1998 and 2001. Unfortunately, updates or additional data were not made available. If additional data were available, additional analyses could be undertaken for the calculation of the annual appreciation rate in the housing market for multiple years and for the inclusion of more independent variables, among other things.

The transaction database provided property addresses, prices and dates of sales, appraised land and building values, and land use codes. The data were reorganized so that there was one record per property, containing all of the transactions that took place during the four-year time period. Between 1998 and 2001 there were 4,845 property transactions within the City of Mansfield (Land Use Code 510). In the data set provided by Richland County’s Auditor’s Office the number of buildings with two or more units that might have been flipped is very small (Land Use Codes other than 510). According to the 2000 Census, 65% of all occupied housing units in Mansfield are single-family homes, almost 10% are duplexes, and 25% fall into other categories.

Data from the U.S. Census were added to the data provided by Richland County’s Auditor’s Office. Information on phony paperwork and deceptive sales pitches would have made this data set ideal for a comprehensive discussion on property flipping, given the U.S. Senate’s (2001) definition.

Unfortunately, the latter aspects could not be investigated because of a lack of authority and access to potential data. Thus, only one component of the definition, price mark-up, will be analyzed below.

Mansfield, a city with a population of about 50,000, was severely affected at the beginning of the 1990s when Westinghouse—a major employer—left the city. Westinghouse's departure had a negative impact both on Mansfield's local economy and its housing market. After such an incident, properties are assumed to turn over slowly and price increases are assumed to be modest. However, Richland County's Fair Housing/Community Development Officer believed that properties had been turning over too quickly and with more rapid price increases than the market warranted (James Mitchell, Fair Housing/Community Development Officer Richland County, personal communication, October 1, 2001). In other words, he believed that homes were being sold at a price mark-up atypical of the community, one of the components of the definition of property flipping that has not been pursued in the academic literature.

In order to identify those properties that were sold for a price mark-up atypical of the community, one may want to differentiate between a local average appreciation and the price appreciation of a property in question. For Mansfield, Richland County's Fair Housing/Community Development Officer believed that the local average appreciation had been near zero for several years prior to 2001. Taking a 0% appreciation as a basis for the quantitative analysis would have made a transaction with any positive appreciation a potentially flipped transaction. In order to avoid including honestly sold, positively appreciated properties while still including potentially flipped properties, a threshold of 10% annual appreciation was decided upon by local experts. Also, properties that turned over multiple times within the four-year timeframe, much faster than in comparable housing markets, were believed to have been flipped (James Mitchell, Fair Housing/Community Development Officer Richland County, personal communication October 1, 2001).

More specifically, potentially flipped properties were selected based on a methodology that factored in the time between transactions (the "quick resale" mentioned in the definition) and the appreciation between transactions

(the “huge price mark-up” pointed out in the definition): (a) properties with 10% or more annual appreciation between 1998 and 2001, (b) fewer than 180 days between transactions, and (c) three or more transactions between 1998 and 2001 (James Mitchell, Fair Housing/Community Development Officer Richland County, personal communication, October 1, 2001, and Roberta Garber, Executive Director Community Research Partners, personal communication, October 1, 2001). This methodology will be used for the model, as discussed below.

Next, the annual appreciation rate, the number of days between transactions, and the number of transactions over the four-year time span from January 1998 to December 2001 were calculated. The chosen methodology, with the threshold of three turnovers within four years, left 100 transactions, whereas a potential threshold of four turnovers within four years would have left fewer than 30 transactions. Having fewer than 30 transactions in an analysis is not desirable from a statistical point of view, since characteristics of the normal distribution are violated (Daniel & Terrell, 1995).

The dependent variable is a ratio; thus, Poisson regressions were used. Logit and probit regressions call for binary or categorical dependent variables (Hamilton, 1992). The regression model has properties as the dependent variable, expressed as a ratio of the number of properties filtered out by the methodology over the number of occupied housing units (see Table 1).

Quantitative analyses are conducted for census block groups within the City of Mansfield. All independent variables were taken from the 2000 Census (see Table 2).

The dependent variable, however, encompasses transactions from 1998 to 2001. This timing might induce simultaneity-equation bias in the coefficient estimates of some of the neighborhood variables. In this case, the coefficient estimates would capture not only the impact of a neighborhood on potential flipping activity but also the impact of potential flipping on a neighborhood (Greene, 2003). The author of this article argues that it might take some time for potential flipping activities to affect a neighborhood. Thus, transactions for four years—instead of only one year, which would have resulted in fewer cases—were taken for the analysis.

Table 1. Dependent Variable: Descriptive Statistics

Census Block Group	Number of Properties (RCAO)	Number of Housing Units (2000 U.S. Census)	Ratio (author's calculation)	Standardized Residuals
1001	0	200	0.00	0.01237
2001	1	184	0.01	-0.48381
3001	10	428	0.02	2.91842
3002	7	415	0.02	0.21846
4001	7	510	0.01	0.98958
4002	1	678	0.00	-1.81476
5001	10	1,058	0.01	0.36014
5002	3	1,053	0.01	0.21130
6001	11	906	0.00	-0.94494
6002	4	806	0.01	-1.59413
7001	8	383	0.00	0.65901
7002	7	920	0.02	-1.82899
8001	0	389	0.01	0.72364
8002	5	495	0.00	0.72416
8003	3	340	0.01	-0.07264
9001	0	1,012	0.01	-0.70607
9009	0	256	0.00	0.17116
10001	2	741	0.00	-0.21455
10002	2	1,040	0.00	-0.20848
10009	0	753	0.00	0.40207
11001	0	474	0.00	-0.60284
11002	1	789	0.00	-0.25237
12001	2	879	0.00	0.67207
12002	2	793	0.00	0.08422
13001	1	959	0.00	-0.08521
14001	4	544	0.01	0.63505
15001	0	300	0.00	-0.16207
15002	1	352	0.00	0.81106
15003	1	342	0.00	-0.38776
16001	0	351	0.00	0.07500
16002	1	483	0.00	-0.96137
17009	0	153	0.00	0.15277
18002	0	682	0.00	-0.21119
21011	0	492	0.00	-0.61862

Table 1. Dependent Variable: Descriptive Statistics (cont.)

Census Block Group	Number of Properties (RCAO)	Number of Housing Units (2000 U.S. Census)	Ratio (author's calculation)	Standardized Residuals
21012	0	581	0.00	-0.04705
21013	0	563	0.00	-0.10790
21014	6	545	0.01	2.15804
21021	0	578	0.00	0.20751
21022	0	762	0.00	-0.08988
23009	0	413	0.00	-0.67963
27004	0	357	0.00	-0.11180
<i>N</i>	41			
Sum	100			
Mean	2.44			
Std. Dev	3.248			

Sources: Richland County Auditor's Office (RCAO) and 2000 U.S. Census

Results

It is assumed that neighborhoods in which flipping activities take place are characterized by those housing-unit related and socioeconomic characteristics that are also typically found in challenged neighborhoods (U.S. Senate, 2001). This section will discuss what specific factors are associated with neighborhoods affected by potential flipping activities, based on the quantitative analysis in the previous section. Descriptive statistics are shown in Table 3.

The descriptive statistics compare the mean of the independent variables of the City of Mansfield and the State of Ohio. Compared with Ohio, Mansfield has some characteristics that are assumed to attract potential flippers. With respect to buildings, Mansfield's building vacancy rate is almost 10%, whereas Ohio's rate is only 7%; and Mansfield's housing unit value is less than \$75,000, whereas Ohio's housing unit value is more than \$100,000. With respect to demographics, Mansfield's proportion of householders 75 years and older as well as its proportion of African American householders is almost 14%, whereas Ohio's proportion of each is about 10%. Table 4 shows the results of the Poisson regression.

As mentioned above, the regression model has a dependent variable selected by the methodology. The dependent variable is expressed as a ratio. In

Table 2. Independent Variables: Specifications, Expectations of Signs, and Sources

Name of Variable	Expectation of Sign of Coefficient--Hypothesis	Supporting Literature	Source
Proportion of Vacant Housing Units	positive—flippers prey on neighborhoods that are in the process of filtering down (i.e., the higher the proportion of vacant housing units the higher the number of properties potentially affected by flipping)	Bier and Post (2003)	2000 U.S. Census SF1 H3
Age of Housing Unit	positive—flippers prey on neighborhoods that have an old housing stock (i.e., the older the housing unit the higher the number of properties potentially affected by flipping)	Ratcliff (1949)	2000 U.S. Census SF3 H35 [variable modified by author]
Housing Unit Value	negative—flippers prey on neighborhoods that have low housing unit values (i.e., the higher the housing unit value the lower the number of properties potentially affected by flipping)	Bier and Post (2003)	2000 U.S. Census SF3 H76
Average Household Size	unclear—flippers might prey on neighborhoods that have small household sizes/a low number of earners per household (?)	[none]	2000 U.S. Census SF3 H76
Proportion of Housing Units Rented Out	positive—flippers prey on neighborhoods that have a high proportion of renters/rented out properties (i.e., the higher the proportion of renters the higher the number of properties potentially affected by flipping)	Bier and Post (2003)	2000 U.S. Census SF1 H4
Housing Units without Mortgage	unclear—homes owned “free and clear” are likely to be located in neighborhoods that are characterized by a high home ownership rate, which might not be a preferred activity area of flippers (?)	[none]	2000 U.S. Census SF3 H80
Median Household Income	negative—neighborhoods with a high median household income are unlikely to be preferred by flippers (i.e., the higher the median household income the lower the number of properties potentially affected by flipping)	[none]	2000 U.S. Census SF3 P53
Proportion of Senior Householders 75 Years and Up	positive—flippers prey on senior citizens who are often impaired by physical and/or mental health issues and thus easier to mislead (i.e., the higher the proportion of senior householders the higher the number of properties potentially affected by flipping)	Senate (2001) Senate (2000a) Senate (2000b)	2000 U.S. Census SF1 H16
Proportion of African American Householders	positive—flippers prey on African Americans who often face constraints that hindered them from becoming homeowners in the past (i.e., the higher the proportion of African American householders the higher the number of properties potentially affected by flipping)	Senate (2001) Senate (2000a) Senate (2000b)	2000 U.S. Census SF1 H6

Table 3. Independent Variables: Descriptive Statistics

	City of Mansfield: Mean	Ohio: Mean
Proportion of Vacant Housing Units	9.63%	7.05%
Age of Housing Unit	44 years	38 years
Housing Unit Value	\$73,046	\$103,700
Average Household Size	2.35	2.49
Proportion of Housing Units Rented Out	39.29%	30.89%
Housing Units without Mortgage	38.71%	30.67%
Median Household Income	\$31,613	\$40,956
Proportion of Senior Householders 75 Years and Up	13.61%	10.54%
Proportion of Householders African American	13.39%	11.05%

Sources: RCAO and 2000 U.S. Census

the model the number of significant variables is five although the R-squared is high which might suggest omitted variable bias. Thus, the current results should be interpreted carefully.

With respect to building characteristics, the model has a significant coefficient with a positive sign with respect to the variable Housing Unit Vacant. This finding partly supports the hypothesis that neighborhoods with a high vacancy rate might have a high number of potentially flipped properties. The sign of the variable Housing Unit Age is insignificant in the model, not supporting the hypothesis above. This invites future research. Similar to the first variable, Housing Unit Value, the model has a significant coefficient with a negative sign. These findings also partly support the hypothesis that neighborhoods with low housing unit values might have a high number of potentially flipped properties.

With respect to households, the variable Household Size was significant, with a positive sign. This indicates that neighborhoods with large household sizes might have a high number of potentially flipped properties. Household sizes nevertheless do not indicate the number of earners. Householders 75 Years and Up was positive and significant. This confirms that neighborhoods with a high proportion of senior citizens might have a high number of potentially flipped properties. The variable African American Householder was also significant and positive, confirming that neighborhoods with a high proportion of African American householders might have a high number of potentially flipped properties.

Table 4: Regression Results (Poisson Regression)

Variable	Unstandardized Coefficient	Standardized Coefficient	T-statistic	Significance
Proportion of Vacant Housing Units	0.022	0.372	2.198	0.036
Age of Housing Unit				
Housing Unit Value	-0.00004	-0.405	-2.257	0.031
Average Household Size	0.055	0.486	2.801	0.009
Proportion of Housing Units Rented Out				
Housing Units without Mortgage				
Median Household Income				
Proportion of Senior Householders 75 Years and Up	0.033	0.404	2.839	0.008
Proportion of Householders African American	0.014	0.459	3.341	0.002
F-test	12.415			
Significance	.000			
R-Squared	.783			

Note. Only significant results shown (significance level: 5%)

Neighborhoods in Mansfield affected by potential flipping activities are characterized by those housing-unit related and socioeconomic characteristics that are typically found in challenged neighborhoods, such as a high proportion of vacant housing units, low housing values, and a high proportion of racially and ethnically underrepresented groups, among others. While this finding is not surprising (see also U.S. Senate (2001)), it might nevertheless be useful for the public policy debate that should incorporate these findings.

Public Policies

The first part of this article concentrated on the hypothesis that neighborhoods affected by potential flipping activities are characterized by those housing-unit related and socioeconomic characteristics that are also typically found in challenged neighborhoods. Results from the quantitative analyses above show that a high proportion of vacant housing units, low housing unit values, large average household sizes, and high proportions of senior and African American householders might “attract” flipping into a neighborhood.

Whereas vacant housing units might be considered an opportunity by flippers, neighborhoods with low housing unit values could be the areas into which some African American householders might consider buying. Also, some senior and/or African American householders might be characterized as having challenged judgments due to lower levels of formal education and fewer life skills, among other factors. In addition to these housing-unit related and socioeconomic characteristics, there might be characteristics related to participants in the home buying and lending process that do not deter flipping in certain neighborhoods. Examples of these participants are mortgage lenders, appraisers, and inspectors.

Even when addressing property flipping, housing-unit related and socioeconomic characteristics are difficult to change through public policies, especially in the short run. However, characteristics of the participants in the home buying and lending process might be easier to change, as will be discussed below. The following paragraphs will discuss potential public policies that can address property flipping, focusing on the home buyer, lender, appraiser, and inspector.

Potential future public policies that address property flipping should especially focus on home buyers in neighborhoods that are characterized by variables that are significant in the model, such as a high proportion of vacant housing units, low housing unit values, and high proportions of senior or African American householders. Home buyers in these neighborhoods might be first-time home buyers (except for senior householders who are assumed to be experienced) who are inexperienced in financial matters. This inexperience might be preyed upon by flippers (U.S. Senate, 2001). (Although transactions were made available by the Richland County Auditor's Office, information on whether home buyers were first-time home buyers was not part of the data set.) Thus, it is suggested that financial literacy should be improved.

There are several ways to accomplish this goal. For example, the U.S. Department of Housing and Urban Development (HUD)-certified homeownership counseling program is open to income-eligible, first-time home buyers. It offers two components, one-on-one financial counseling and a homeownership training/life skills seminar. In the counseling component, participants' credit reports, financial needs, money management, budgeting,

savings building, and critical financial planning strategies are analyzed. In the seminar, component issues, such as home inspection, working with a realtor, the mortgage process, and how to avoid a predatory lender, are covered. This program is not only an important resource to increase home buyers' comfort levels with financial matters, it might also prevent them from becoming victims of flipping (Kass, 2001; "H.E.L.P.," 2002; Hirad & Zorn 2002; "Solid Foundations," 2001). HUD's certified homeownership counseling program should not only be offered in more communities, but it should also be made more known in neighborhoods characterized by the variables mentioned above.

Another participant in the home buying and lending process is unsuspecting lenders ("The Next," 2000; Collins, 2001a-c; Johnson, 2002). In developing policies to combat flipping it is important to keep the lending process as fast, unbureaucratic, and efficient as possible while also preventing lenders from becoming victims of property flipping. As one of the models above shows, neighborhoods potentially targeted by property flippers have low housing unit values. Because of this, many of the buyers might consult lenders to take out mortgages insured by the Federal Housing Authority (FHA). In the case of FHA-insured loans, losses are paid by the FHA and, ultimately, the taxpayer. Thus, selling FHA-insured loans becomes a risk-free exercise for lenders. This is why public policies should pay special attention to FHA-insured loans that might be issued in connection with a flipping scheme.

FHA authorizes lenders to originate FHA-insured loans, i.e., they can accept mortgage applications, obtain the employment verifications and credit histories of applicants, order appraisals, and perform other tasks that precede the loan underwriting process. About one quarter of the lenders authorized by the FHA to originate FHA-insured loans have Direct Endorsement (DE) authority. DE lenders can gather and process loan information, underwrite the loans, and make eligibility determinations without HUD's prior review (U.S. Senate, 2001).

Prior to 1983, only FHA employees had DE authority, and they underwrote most loans prior to insurance endorsement. Then, the FHA began delegating DE authority to approved lenders, although HUD still reviews selected properties and mortgage credit analyses through the post-endorsement technical review and on-site lender review processes. In

addition, at the end of the 1990s HUD established a Homebuyer Protection Plan that improved the appraisal process and introduced Credit Watch, a performance-based lender monitoring and enforcement system (U.S. Senate, 2001). The FHA began to delegate DE authority to approved lenders in the interest of a fast, unbureaucratic, and efficient lending process, but the increased incidence of property flipping shows that the system is not faultless (U.S. Senate, 2001).

Lenders have an obvious and significant financial interest in loan approval. When given DE authority they might become biased and seem to approve too many loans that are likely to default. In the case of FHA-insured loans, losses are initially paid by the FHA but ultimately paid by the taxpayer. Thus, selling FHA-insured loans can be considered a risk-free exercise for lenders.

Another problem is that many lenders are either not local or are from out of state (Ettlin, 2001). This means that lenders who are unfamiliar with local situations may not realize that there are discrepancies between true market values and appraisals, especially in neighborhoods where property values are low.

There are several options to improve this undesirable situation. First, DE authority should either be contracted out to a third party not involved in the process or resumed by the FHA—whichever option is more efficient and effective. Second, DE authority should be broken apart so that lenders with DE authority may still initiate the process, but FHA or another third party should complete it. Third, FHA should monitor mortgages in those geographical areas that might be targeted by flippers, as discussed above. Fourth, FHA should regularly screen parties that have obtained DE authority. Fifth, FHA-insured mortgages provided by non-local lenders should be appraised at the local level to avoid discrepancies between true market values and inflated appraisals. Sixth, the sales histories of past years should be included in mortgage applications in order to see the appreciation history of properties.

The home buying process also involves appraisers and inspectors (“The Next,” 2000; Collins, 2001a-c; Johnson, 2002). Because appraisals often factor in some speculative aspect about future prospects of properties and their neighborhoods, especially if they are located in areas that have appreciated in the past, they tend to overvalue properties. Appraisals can fall into a gray area

in which it is difficult to determine the borderline between slightly inflated appraisals that encompass some speculative aspects about future prospects and inflated appraisals that are part of property flipping schemes. Appraisals are probably unethical when there is a vast discrepancy between appraised value and true market value. It is also probably unethical, if not illegal, when a seller asks an appraiser to increase the appraised value of a property or tells the appraiser what the property needs to be appraised at to make the deal work (Schuldt, 2001; Murray & Stoltz, 2002).

On the other hand, there have been allegations that appraisers undervalue properties in areas characterized by low incomes and/or racially and ethnically underrepresented groups. Another issue is that the precision of appraisals depends upon the quantity and frequency of previous home sales. Neighborhoods with few and infrequent transactions tend to have appraisals that are less precise (Lang & Nakamura, 1993; see also King (1981) and Quan & Quigley (1991)). Since they are usually hired by lenders, appraisers depend on them for their livelihood. If an appraisal does not satisfy a lender, the appraiser might not be consulted again. Because of this setup, honest appraisers might feel compelled to submit inflated appraisals that please the lenders who pay them ("Solid Foundations," 2001). Thus, they might stop being honest.

Appraisals are a critical component of the lending process in connection with FHA-insured mortgages, especially when loan-to-value ratios are high (U.S. Senate, 2001). Until 1994, HUD selected appraisers from HUD's FHA Appraiser Fee Panel on a rotating basis to appraise properties for each proposed mortgage (Wallace, 2000). Appraisers on the panel were required "to demonstrate a high level of experience and be knowledgeable about the appraisal process and property standards that homes being considered for FHA-insured mortgages must meet" (U.S. Senate, 2001, p. 12). At least 10% of appraisals were then reviewed by FHA employees. This practice was stopped in December 1994, when amendments to the National Housing Act delegated appraisal selection responsibilities from FHA employees to DE lenders. DE lenders are now allowed to select appraisers licensed by the state in which they practice. Flipping may entail lenders choosing certain appraisers over others in order to obtain the results they desire (U.S. Senate, 2001).

In order to reestablish the integrity of its appraisals, HUD should

resume reviewing them. In the meantime, the intended Appraiser Watch Initiative should be reintroduced. In the long run, the licensing systems of the states should be overhauled and evaluations of licensed appraisers by each state should be undertaken on a regular basis (“Appraisal Institute Pledges,” 2001a; “Appraisal Institute Calls,” 2001b; “Solid Foundations,” 2001).

Other participants in the home buying process are inspectors, and public policies should pay close attention to them in connection with FHA-insured mortgages. At present, the FHA does not require home buyers to obtain home inspections as a prerequisite to obtaining FHA-backed mortgages, although they emphasize that home inspections are important. Anecdotal evidence suggests that some flippers discourage potential home buyers from obtaining home inspections, telling them that their homes were inspected when they were not, undertaking and signing home inspection forms themselves, telling them that appraisals are inspections, and so on (U.S. Senate, 2000a, 2001).

Home inspectors are mostly independent specialists who work for fees that they receive directly from the home buyer. In cases of flipping, many victims do know that it is wise to get a home inspection, but they might not have known about independent (i.e., third party) home inspectors. Also, some home buyers do not have the money to pay for a home inspection.

The fact that home inspections cost money often discourages low-income home buyers from obtaining them. However, home inspections are a critical component within the home buying process. Many cases of property flipping would be prevented by making a home inspection mandatory (U.S. Senate, 2000a). In order to make homeownership for low-income home buyers attainable, fees for home inspections could be partly subsidized by the public sector and partly loaned to prospective home buyers by an independent third party who is not involved in the process (“Solid Foundations,” 2001).

Although the focus of policies should be to prevent flipping from happening in the first place, policies should also address situations after flipping has occurred. This may be especially important to protect the credit rating of victimized home buyers. In cases of flipping, homeowners often default on their mortgages. Thus, their credit scores are significantly harmed, making it difficult, if not impossible, to obtain another mortgage (“\$5 Million,” 2002;

O'Donnell, 2001f; Newman, 2002). HUD suggests that in cases in which flipping has occurred, lenders should issue so-called credit repair letters that are designed to help ensure that victims' credit records are not harmed (U.S. Senate, 2001). Since lenders could be part of a flipping scheme, requesting that they issue credit repair letters might be a biased approach. Instead, somebody unbiased in the process, such as HUD, should issue the letters. According to HUD's suggestion, credit repair letters would only be issued to victims of schemes in which the perpetrators are successfully prosecuted, meaning that they would be of limited assistance.

Limitations, Future Research, and Conclusion

This article presents a Poisson regression model that explains factors that affect neighborhoods with high proportions of potentially flipped properties based on a case study in Mansfield, Ohio. These neighborhoods are characterized by factors similar to those typical of challenged neighborhoods. In the case of Mansfield, quantitative results indicate that Household Size and the Proportion of African American Householders are very important, as these variables were significant in the model. The Proportion of Vacant Housing Units, the Proportion of Householders 75 years and Up, and the Value of the Housing Unit were important variables in the model, among other variables.

The current model is very limited since it is based on a data set that only contains transactions from 1998 to 2001—the ideal data set would contain transactions for many years, ideally overlapping with several Census years, for example 1980, 1990, and 2000. The current model suffers from simultaneity-equation bias which should be corrected in future models. The current model also does not incorporate a lag time indicator that indicates when potential flipping activities affect the neighborhood. The current model is weak as there are only five significant variables that explain an R Squared of .783, probably indicating omitted variables.

Future research should focus on additional variables currently not available from the U.S. Bureau of the Census. Future research activities should also be conducted in similar communities, as well as larger cities, to find out whether the variables discussed above or different variables, such as variables

related to lending, explain flipping, and to gain more insights on property flipping in general.

Although flipping was defined by the U.S. Senate, its current definition is only descriptive. Because it focuses on phony paperwork and deceptive sales pitches as criteria, it will not help to detect it quickly enough. Victims of flipping not only need to realize that they have been victimized, they also need to step forward. However, some victims might be reluctant and discouraged to do so because their experience was traumatic, the burden of proof is cumbersome, or fees are not affordable in terms of time and resources. Thus, some victims might decide not to start a potential prosecution process in the first place, and if they do prosecution might take a long time.

Real estate property flipping often involves several actors who might not be aware of their part in a flipping scheme. Current public policies try to keep the home buying process as fast, unbureaucratic, and efficient as possible. However, flipping activities in Baltimore have shown that the system is not faultless. Future public policies should focus on improving homeownership counseling and on increasing oversight of lenders, appraisers, and inspectors in connection with FHA-insured mortgages.

According to government reports (most of them were written before September 11, 2001) local and federal law enforcement have traditionally been reluctant to prosecute flipping and other types of mortgage fraud cases because they are highly technical and difficult to prove. The work undertaken in Mansfield shows that questionable property transactions can be relatively easily identified, forming the basis for suggested future policies and further research in connection with real estate property flipping in other communities.

References

- Appraisal institute pledges support to HUD Secretary in solving predatory lending and fair housing issues. (2001a, May 14). *PR Newswire*, pp. na.
- Appraisal institute calls upon National Credit Union Administration to retain current appraisal threshold. (2001b, May 14). *PR Newswire*, pp. na.
- Benson, D. (2002a, February 10). Some lenders seek prey. *Mansfield News Journal*, pp. na.
- Benson, D. (2002b, February 10). Area agents concerned about fair lending. *Mansfield News Journal*, pp. na.

- Benson, D. (2002c, February 10). Salesmen often innocent. *Mansfield News Journal*, pp. na.
- Benson, D. (2002d, February 10). AARP fights against predators. *Mansfield News Journal*, pp. na.
- Better Protect Low-Income Home Buyers (2001, December 10), *The Morning Call (Allentown)*, pp. na.
- Bier, T., & Post, C. (2003). *Vacating the city: An analysis of new homes vs. household growth*. Washington, DC: The Brookings Institution. The Living Cities Census Series.
- Carr, J. H., & Kutty, N. (Eds.) (2008). *Segregation: The rising costs for America*. New York, NY: Routledge.
- Chatterjee, L., Harvey, D., & Klugman, L. (1974). *FHA policies and the Baltimore City housing market*. Baltimore, MD: na.
- Collins, B. (2001a, May 5). FHA lenders face scrutiny. *National Mortgage News*, pp. na.
- Collins, B. (2001b, May 21). Lenders resist pressure to write down Baltimore loans. *National Mortgage News*, pp. na.
- Collins, B. (2001c, September 10). HUD proposes measures to reduce FHA defaults. *National Mortgage News*, pp. na.
- Community Research Partners and Center for Urban and Regional Analysis. (2002). *Analysis of residential property sales in Mansfield, Ohio*. Report. The Ohio State University. Retrieved December 25, 2008, from www.communityresearchpartners.org/uploads/publications//Mansfield%20Report%20Final.pdf
- Daniel, W. W., & Terrell, J. C. (1995). *Business statistics*. Boston et al., MA: Houghton Mifflin Company.
- Day of reckoning. Flipping: Federal flipping charges could help weed out nefarious lending practices in Baltimore. (2001, April 30). *The Baltimore Sun*, pp. na.
- Dedman, B. (1988a, May 1). The color of money: Atlanta blacks losing in home loans scramble: Banks favor white areas by 5-1 margin. *The Atlanta Journal-Constitution*, p. A1.
- Dedman, B. (1988b, May 1). The color of money: A tale of two neighborhoods, one black and one white. *The Atlanta Journal-Constitution*, p. A14.
- Dedman, B. (1988c, May 1). The color of money: How study of home loans in metro Atlanta was carried out. *The Atlanta Journal-Constitution*, p. A16.
- Dedman, B. (1988d, May 2). The color of money: Southside treated like banks' stepchild: Blacks may shun some home-loan lenders because they're

- shunned first, critics say. *The Atlanta Journal-Constitution*, p. A1.
- Dedman, B. (1988e, May 2). The color of money: Poor may be left behind by bank deregulation: Basic services lagging as institutions court the wealthier clients. *The Atlanta Journal-Constitution*, p. A5.
- Dedman, B. (1988f, May 3). The color of money: A test that few banks fail – in federal eyes: Regulators say 98 percent obey lending law, but skeptics say communities shorted. *The Atlanta Journal-Constitution*, p. A1.
- Dedman, B. (1988g, May 4). The color of money: City hall clout could sweeten home-loan pot: Municipal deposits a bargaining chip, activists contend. *The Atlanta Journal-Constitution*, p. A9.
- Engel, K. C., & McCoy, P. A. (2002). A tale of three markets: The law and economics of predatory lending. *Texas Law Review* 80 Tex. L. Rev. 1255. Retrieved September 3, 2003, from http://web.lexis-nexis.com/universe/document?_m=4876462eee4b7a513593c322d5def8b7&_docnum=1&wchp=dGLbVtz-zSkVA&_md5=7b3b6ff4e130d5644f90edd8cfc05190.
- An epidemic of defaults. (2002, July 16). *The Baltimore Sun*, pp. na.
- Ettlin, D. M. (2001, August 17). Man sentenced in house scheme and ordered to pay \$1.5 Million. *The Baltimore Sun*, p. na.
- \$5 Million fund spells relief for victims of property-flipping. (2002, June 25). *Associated Press State & Local Wire*, pp. na.
- George, H. (1955). *Progress and poverty*. New York, NY: Robert Schalkenback Foundation.
- Greene, W. H. (2003). *Econometric analysis*. Upper Saddle River, NJ: Prentice Hall.
- Guttentag, J. M., & Wachter, S. M. (1980). Redlining and public policy. New York University. Graduate School of Business Administration. Salomon Brothers Center for the Study of Financial Institutions. Monograph Series in Finance and Economics. Monograph 1980-1.
- Hamilton, L. C. (1992). *Regression with graphics: A second course in applied statistics*. Belmont, CA: Duxbury Press.
- Harvey, D. (1975). Class-monopoly rent, finance capital and the urban revolution. In S. Gale & E. G. Moore (Eds.), *The manipulated city: Perspectives on spatial structure and social issues in urban America* (pp. 145-198). Chicago, IL: Maaroufa Press.
- H.E.L.P. for Baltimore flipping victims. (2002, May 11). *The Daily Record*, pp. na.
- Hirad, A. & Zorn, P. (2002). Prepurchase homeownership counseling: A little

- knowledge is a good thing. In N. P. Retsinas & E. S. Belsky (Eds.), *Low-income homeownership: Examining the unexamined goal*, (pp. 146-174). Cambridge, MA and Washington, D.C.: Joint Center for Housing Studies and Brookings Institution Press.
- Hite, J. C. (1979). *Room and situation: the political economy of land-use policy*. Chicago, IL: Nelson-Hall.
- Immergluck, D., & Wiles, M. (1999). *Two steps back: The dual mortgage market, predatory lending, and the undoing of community development*. Chicago, IL: Woodstock Institute.
- James, M. (2002, April 7). Chasing a new 'path of destruction': Investigators accuse convicted swindler in flipping schemes. *The Baltimore Sun*, pp. na.
- Johnson, M. (2002, May 6). Prosecutor proved himself on tough cases. *Milwaukee Journal Sentinel*, pp. na.
- Kass, B. L. (2001, October 20). Beware of fraud in "flipping schemes." *The Washington Post*, pp. na.
- King, A. T. (1981). *Discrimination in mortgage lending: A study of three cities*. New York University. Graduate School of Business Administration. Salomon Brothers Center for the Study of Financial Institutions. Monograph Series in Finance and Economics. Monograph 1981-5.
- Lang, W. W., & Nakamura, L. I. (1993). A model of redlining. *Journal of Urban Economics*, 33, 223-234.
- Murray, T. D., & Stoltz, M. (2002, June 22). Mortgage fraud probes disclosed. Hundreds of Cuyahoga homes possibly involved in schemes. *The Plain Dealer*, pp. na.
- Newman, R. (2002, June 25). Better deal worked out for cheated home buyers. Corzine announces plan by U.S. and banks. *The Record*, pp. na.
- The next frontier in mortgage fraud: The threat within (2000, September 5). *Credit Risk Management Report*, pp. na.
- O'Donnell, J. B. (2000, December 3). Flippers fleece an unwary city. Homebuyers lose their dreams, lenders lose millions, and the foreclosures leave neighborhoods rotting. *The Baltimore Sun*, pp. na.
- O'Donnell, J. B. (2001a, April 27). 16 charged in flipping properties. Prosecutors say scheme cost FHA nearly \$4 million. 58 area deals examined. Perry Hall agent said to have grossed \$1.4 million in deals. *The Baltimore Sun*, pp. na.
- O'Donnell, J. B. (2001b, May 15). Housing fraud still high, U.S. Senate panel told. Federal efforts have failed to prevent thousands of flipping deals,

- officials say. *The Baltimore Sun*, pp. na.
- O'Donnell, J.B. (2001c, July 19). Probation given in conviction on property flipping. Overlea man is spared federal prison sentence because of ill health. *The Baltimore Sun*, pp. na.
- O'Donnell, J.B. (2001d, July 28). Man gets 21 months for flipping scheme. 2 others plead guilty in separate case. *The Baltimore Sun*, pp. na.
- O'Donnell, J.B. (2001e, September 3). Guilty pleas expected in flipping case. Perry Hall broker to admit to property scheme, lawyers say. Co-defendants make deals. False papers used for \$4.4 million in mortgages, U.S. says. *The Baltimore Sun*, pp. na.
- O'Donnell, J.B. (2001f, September 11). Forest Park "flipping" suit settled. Woman to receive mortgage reduction. *The Baltimore Sun*, pp. na.
- O'Donnell, J.B. (2001g, September 22). City Man pleads guilty to arson conspiracy in property scheme. Fire was set at rowhouse after "flipping" plan failed, prosecutors say. *The Baltimore Sun*, pp. na.
- Quan, D. C., & Quigley, J. M. (1991). Price formation and the appraisal function in real estate markets. *Journal of Real Estate Finance and Economics*, 4, 127-146.
- Ratcliff, R. U. (1949). *Urban land economics*. New York, NY et al.: McGraw-Hill Book Company.
- Schuldt, G. (2001, November 30). Man linked to case files bankruptcy. He was associated with company involved in property flipping. *Milwaukee Journal Sentinel*, pp. na.
- Solid foundations to help victims. (2001, May 21). *National Mortgage News*, pp. na.
- Squires, G. D. (1992). Community reinvestment: An emerging social movement. In G. D. Squires (Ed.), *From redlining to reinvestment: Community responses to urban disinvestment*, (pp. 1-37). Philadelphia, PA: Temple University Press.
- Squires, G. D. (2003). Introduction: The rough road to reinvestment. In G. D. Squires (Ed.), *Organizing access to capital: Advocacy and the democratization of financial institutions* (pp. 1-26). Philadelphia, PA: Temple University Press.
- U.S. Senate. (2000a). Committee on Appropriations. *Form of real estate fraud known as flipping: Hearing before a subcommittee of the Committee on Appropriations*. 106th Cong., 2nd sess.
- U.S. Senate. (2000b). Committee on Governmental Affairs. *HUD's government-insured mortgages: The problem of property flipping. Hearing before the*

- Permanent Subcommittee on Investigations. 106th Cong., 2nd sess.*
- U.S. Senate. (2001). Committee on Governmental Affairs. *Property "flipping": HUD's failure to curb mortgage fraud. Report prepared by the minority staff of the permanent subcommittee on investigations of the Committee on Governmental Affairs United States Senate. 107th Cong., 1st sess.*
- Wallace, K. (2000). Home cheat home. *Mother Jones*, 25, 15-16.